THE NATIONAL CITY BANK OF NEW YORK

1950

Monthly Letter on
Economic Conditions Government Finance

New York, August, 1950

The Nation Rearms

THE developments of the past six weeks in Korea have brought to the free peoples throughout the world a new sense of the immediacy and magnitude of the peril that faces them from armed aggression. Notwithstanding recognition, in the first news of the attack upon South Korea, of the grave menace to world peace, it was widely hoped that the South Korean Government forces, with such military assistance as could be made promptly available by the United States and other members of the United Nations, would be able to contain the invasion; and that such check, coupled with the moral force of United Nations' condemnation would have its effect upon those responsible for aggressive action, lead to a withdrawal of the invading armies, and an amelioration of the crisis.

The actual unfolding of events swiftly and tragically shattered these hopes. The aggressor has pressed on with a determination, power, and effectiveness that bespeak long and careful preparation. Not only has it become clear that the task of overcoming him will be longer and harder than at first supposed, but, as President Truman said in his message to Congress on July 19, the attack upon the Republic of Korea "makes it plain beyond all doubt that the international Communist movement is prepared to use armed invasion to conquer independent nations." Thus, as the President went on to state, the United States must increase its military strength and preparedness not merely to deal with aggression in Korea, but—over and above that—to meet possible armed aggression elsewhere.

As an initial step to cover these needs and contingencies, the President asked Congress for additional appropriations of $10½ billion for strengthening the armed services.

The Economic Problem

The economic problem posed by these enlarged military requirements is one of fitting them into an economy that is riding on the crest of the wave, and when inflationary forces are already strong. While there was some reason to believe, prior to the Korean war, that production in certain lines was at too high a rate to be long sustained, the upsurge of demand induced by fears of wartime shortages, together with accelerated military buying, has precluded any prospect of cyclical downturn in general business, and has given new impetus to the boom.

The President, in his messages to Congress, deals extensively with this problem. In his midyear Economic Report, submitted July 26, he reminds us that in the emergency created by World War II we were forced to enlarge our military strength until it absorbed almost one-half our entire output. At that time military costs were running at the rate of around $84 billion a year. Today a stepping up of military expenditures from the current rate of $13 billion to $20 to $25 billion would still not exceed 10 per cent of the total national product. In the present

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more limited situation we should, the President says, with more limited measures be able to meet our military requirements and to avoid inflation.

This reference by Mr. Truman to the difference between the full-scale mobilization of World War II and the present program is timely. Many people, in their scramble for goods, appear to be acting as though the two situations were comparable. Unless the international crisis forces much further boosts in defense spending, this is not the case. People who are rushing out to buy automobiles on the theory that this is their last chance "for the duration" might do well to bear in mind that, with production of motor cars now running at the rate of some 8 million a year, even a 50 per cent cut in output would still leave production at the rate of 4 million annually — still a large figure. And doubtless much the same thing could be said of other lines.

The fact is that it is not the military program itself that is causing the greatest threat of shortages and of inflation. It is the sudden uprush of civilian demand inspired by it which is swamping the markets and driving prices higher. In steel, one of the most essential of war materials, E. G. Grace, chairman of the Bethlehem Steel Corporation was quoted as stating that — barring a full-scale war — all military requirements for steel could be handled without "nationalizing or socializing" the steel industry and without a drastic reduction in the manufacture of peacetime commodities. Irving S. Olds, chairman of the United States Steel Corporation, discussing the industry's ability to meet defense orders, pointed to the present annual capacity of 100,000,000 tons and declared that "there should not be fear on anybody's part that there will not be enough steel to take care of any war demand."

The President also urges the need and possibility of getting more production from our already booming economy. There is still, he says in his Economic Report, some slack in the economy as a whole. Even without an unusual increase in the labor force or in hours of work, the present material and human resources of the economy are sufficient, he asserts, to lift total production by the end of this year to an annual rate some $8 to $10 billion above the current rate, with further gains to be anticipated in 1951 and succeeding years.

Control Actions and Proposals

The President recognizes, however, that the build-up for national defense will have to be pushed faster than production as a whole can be expanded. There will be need for measures (1) to assure priority in materials for military and essential civilian uses, and (2) to guard against inflation. People must cut down their spending and consumption.

As to the first point, the President has asked Congress for powers, embodied in the proposed Defense Production Act of 1950, to establish priorities and allocate materials as necessary to promote the national security; to limit the use of materials for non-essential purposes; to prevent inventory hoarding; and to requisition supplies and materials for national defense, particularly excessive and unnecessary inventories. In addition, the proposed legislation contains other and more far-reaching grants of power which many people feel go beyond the requirements of the present emergency and which Congress ought to examine carefully before acting.

For curbing inflation and cutting back the public's spending power, the President rejects at this stage the idea of price controls and rationing. These devices for apportioning consumer scarcities are a usable resource for total emergency. In a situation short of that, experience shows, they can lure off labor and materials to uncontrolled non-essentials, create shortages of essentials that would not otherwise exist, and generally dislocate the price and production structure. Price and rationing controls deal with symptoms of inflation. If they are effective and hold back public spending, they build up a pressure of spending power that will bring all the more rapid price advances when they break down.

The President, to relieve the upward pressure on prices, proposes to rely in major degree upon fiscal and credit measures. Such measures, he points out, can be helpful not only in restraining inflationary pressures, but also in reducing civilian demand for some specific products, such as automobiles and housing, thus making available for necessary military use a larger proportion of an already short supply of critical materials.

As Mr. Truman rightly observes, the more prompt and vigorous we are with general measures, the less need there will be for all of the comprehensive direct controls "which involve the consideration of thousands of individual situations and thus involve infinitely greater administrative difficulties and much greater interference with individual choice and initiative."

Pursuant to his policy of relying upon credit and fiscal measures, the President has taken steps to tighten up mortgage credits — recently expanding at a rate of $5 billion a year — by or-

dering cash down payments of at least 5 per cent on veterans' mortgages, asking higher down payments and more conservative appraisals by the Federal Housing Administration, scaling down the FHA's authorization to insure mortgages, and setting a limit on the commencement of public housing construction in the second half of 1950. At the same time he has asked the Federal National Mortgage Association, subsidiary of the RFC, to hold its purchases of additional mortgages to the "irreducible minimum" and further to intensify efforts to sell mortgages already acquired.

In addition, he has asked Congress for authority to control down payments and maturities of consumer credit, similar to that exercised under Regulation W during the past war, and to extend the authority to cover real estate credit as well. In the area of home mortgages, since the Government has been so aggressively sponsoring easier credit terms, and so far has made only a beginning toward reversing this policy, there is much more that can be done, entirely apart from new powers, to slow the dangerous rise in mortgage credit.

The Federal Reserve during July made no overt move to curb credit expansion on a general scale, but F. Raymond Peterson, president of the American Bankers Association, issued a statement asking banks to guard against loans to consumers and businessmen that might increase "panicky buying."

The Budget and Tax Question

Finally, the President proposes tax increases.

In his message to Congress July 19 he stated that "we should increase federal revenues more sharply than I have previously recommended, in order to reduce the inflationary effect of the government deficit." A week later, following conferences with Congressional leaders, the President submitted plans for an immediate $5 billion tax increase, mainly from higher levies on individual and corporate incomes. This, he warned, would be only an "interim step"; when details have been worked out he would have further proposals to make for a "comprehensive" tax program to meet "long-run" revenue requirements.

Every thoughtful citizen can welcome the President's recognition that serious inflationary hazards reside in government deficits, a danger that certain of his economic advisers have so frequently minimized. Welcome too is the acceptance in Congress of the principle that enlarged government expenditures should be covered out of taxes. But before acting precipitately on taxes, we need a thorough reappraisal of the whole budgetary position in light of the changed international situation and the inflationary threat.

The prospect as of April was for a deficit of $6 billion in the current 1951 fiscal year, with revenues calculated at $36 billion and expenditures as programmed by the President at $42 billion. These estimates, of course, have been thrown completely out of kilter by the course of developments.

The President's request for $10½ billion in additional military appropriations may mean, according to Senator O'Mahoney, chairman of the Joint Congressional Committee on the Economic Report, an increase of $4 billion in actual military outlays during the current fiscal year. The President has warned that he will be asking for still more funds for one or another defense-related activity, and a further rise in expenditures for defense is foreseeable for the succeeding 1952 fiscal year.

The outlook for the budget, and for the taxpayer, is not, however, so bleak as the $6 billion deficit, plus prospective additional defense expenditures, would suggest. There has been a marked improvement in revenue prospects, under existing taxes, which the available official estimates do not take into account. In January the revenue estimate for fiscal '51 was set at $37 billion, lowered in April to $36 billion. A reappraisal of the revenue outlook now would produce an upward revision, possibly to as much as $40 billion.

This is helpful, budgetwise, though insufficient.

Where Expenditures Could Be Cut

Another matter, and one that seems to have escaped adequate notice, is the possibility of curtailing non-essential expenditures in government. This is what the citizen is expected to do in his budget when his taxes are increased. He is entitled to wonder why, if he is to forego some of his spending plans, the government administrator cannot do the same. He is entitled to expect a shakeout in non-essentials — and everyone knows they are there — before resort is had to tax increases.

The President's directive to major government departments and agencies to trim down "as far as practical" projects "which do not contribute to defense or civilian requirements essential in the changed international situation," is good as far as it goes, but it will take a lot of following up. Left to itself, bureaucracy is not likely to find many cuts as "practical", while the number

and variety of projects that can be found to be in some way or other "essential" to the war effort is truly astounding.

In one area — housing — the President has already acted in a manner to affect the budget in asking the Federal National Mortgage Association to reduce its holdings of mortgages. This association, popularly known as "Fannie Mae," which gets its money by drawing on the Treasury, held, as of June 30, $1,055 million in mortgages. The President's budget last January had assumed that the association would add another $990 million to its holdings in the 1951 fiscal year. With mortgages in strong demand, it was already apparent before the Korean crisis that the President's figure was too large. The effect of his request could be to wipe out the $990 million of expenditures for "Fannie Mae" and produce instead an inflow of funds to the Treasury.

In the area of agriculture an even bigger "swing" in favor of the Treasury is potentially possible. The Commodity Credit Corporation had been figured to spend $952 million in the 1951 fiscal year to support farm prices. Another $114 million was scheduled to be spent by the Agricultural Department for the "removal of surplus agricultural commodities." With the widespread anxieties over possible shortages, expenditure of $1,066 million in public funds to hold up prices and remove agricultural products from the market seems more than ever indefensible. Instead, selling from the vast existing stocks might possibly return as much as a billion dollars to the Treasury during the course of the year.

A third general area for cutbacks lies in new programs which the President proposed to launch this year at an aggregate cost in fiscal '51 of $956 million. These included, among others, new aids to education, at a cost of $320 million the first year, and medical schemes partly to be financed by new payroll taxes, partly by charges on the Treasury. Some of these items Congress has already rejected. They are things we have gotten along without and, presumably, can still forego.

A fourth fertile area for cutbacks is in proposed expansion of existing programs. The budget document is studded with such increases. To cite only one item — public works — the Army Corps of Engineers and the Reclamation Bureau are scheduled to spend a record-breaking $961 million on "rivers and harbors" work. A drastic cut here, and in public works generally, simply requires courage to see that public works on such a scale represent an inexcusable waste of money and energy needed for more essential purposes.

A fifth area for review lies in foreign aid of all the "recovery" and "development" types in view of the enlarged military obligations that have been and are being undertaken, the gratifying restoration abroad of production for export, and the rapid amelioration of the "dollar shortage" problem. The needs for the European Recovery Program have been overestimated in the annual budgets. The original estimate for the fiscal year '50, made in January 1949, was $4½ billion, while the amount actually spent in that year was $3½ billion. The President's estimate of funds needed under this program for fiscal '51, $3¼ billion, is generally accepted as excessive.

It seems reasonable to suppose that, in these five areas alone, cutbacks could release $5 billion for defense requirements. More could be realized if the needs of the situation — and the courage of government officials, administrators, and legislators — demanded it.

A Vital Choice

Washington officials warn that a condition of "partial mobilization" may have to be borne for a period of years. The choice in method of finance is a vital one. Increased taxes, as the foregoing figures suggest, is neither the only way nor the best way. Cutting the chaff and the nonessentials out of the existing budget can release manpower, goods, and money more vitally needed for military purposes, and with a minimum dislocation in the citizen's life and discouragement of work incentives. Capacity to bear more taxes should be guarded for a national emergency which we hope will not come but which is a recognized possibility.

The defeat in the Senate last month of efforts led by Senators Douglas of Illinois, Bridges of New Hampshire, Ferguson of Michigan, and Saltonstall of Massachusetts, to lop several hundred millions off rivers and harbors and reclamation appropriations is not very encouraging evidence of the ability of Congress to subordinate politics and local interests to the transcendent need of cutting non-essential costs in every way possible. As Senator Douglas said, "we are all for economy until it comes to economy in one of our own projects." However, if the Administration were willing to exert as determined pressure in promoting economy as it does in promoting higher taxes and certain others of its favored projects, something might be accomplished. And the taxpayer would bear his burden with better grace if his government were setting an example of frugal living.

The Food Situation

The outbreak of war in Korea found American agriculture plagued by surpluses and in the throes of adjusting production downward to more manageable proportions. Even in July the Government was still ordering more storage bins to take care of its record grain holdings, while Congress was authorizing the Commodity Credit Corporation to draw on the Treasury for $2 billion more to carry out price support commitments on the 1950 crops.

The scare buying which developed in a few staples such as sugar, shortening, canned goods, and soaps naturally caused temporary distribution difficulties. But the effect, in the final analysis, can only be to transfer surpluses from the farm, or producer level, to the pantry. Not only is the country well protected by large food reserves but its agricultural plant is more highly mechanized than at the time of Pearl Harbor and can quickly swing into higher production next year, if that should be necessary.

On present prospects, food production will be smaller than during the past two years when surpluses were piling up, but it will be larger than in any of the World War II years and about 20 per cent greater than in 1941. After a slow and backward spring, and an unusually heavy abandonment of winter wheat acreage due to drought and heavy insect infestation in the Southwest Great Plains area, crops responded to the favorable June weather and staged a fine recovery. Based on conditions existing on July 1, the government crop report indicated that the 1950 food and forage crop would be the fourth largest on record, exceeded only by the postwar crops of 1949, 1948 and 1946.

Near Record Grain Supplies

Wheat and the early feed grain crops such as oats, barley and rye now are mostly harvested but corn and the oilseeds still face another month or two of critical growing weather before they are "safe". The wheat crop, both winter and spring, gained ground during June and the total harvest now is indicated at 957 million bushels, ample to meet domestic needs of 700 million for flour, feed and seed and still leave over 250 million for export. This may be all that is required since European importing countries are harvesting the best wheat crops since the end of the war. If more is needed, another 417 million bushels is available in storage from the old crop. Furthermore, instead of a reduction on next year's crop, called for under the price-support system, Secretary Brannan already has set 1951 wheat acreage allotments at the same level as for this year's crop. With average abandonment and yields, this would produce a 20 per cent larger crop next year.

The key to next year's livestock, dairy and poultry production, is this year's corn crop. Under the stimulus of the sharp rise in livestock prices this spring, farmers revised their corn planting intentions upward and, instead of complying with the government's acreage allotment goal, which had been geared for a crop of only 2,627 million bushels, they kept planted acreage to within 4 per cent of last year. Thus the first government estimate placed the 1950 corn crop at 3,176 million, only slightly smaller than last year's. With a record carryover of some 950 million bushels in prospect, the total supply is nearly as large as it was this season. At the same time, switching of acreage from the controlled crops such as wheat and cotton to oats and barley has improved the total feed grain supply outlook, even in relation to expanding livestock numbers. If crop prospects hold, and should future events warrant, a sharp expansion can take place within the next year in livestock, dairy and poultry production, already at record high levels for peacetime.

Expansion in Livestock Well Under Way

The livestock industry is in a particularly favorable position to supply larger meat supplies not only because of the expansion which has taken place in cattle herds and pig crops in recent years, but because the ample feed situation will permit a further stepping up of breeding and feeding. Beef cattle numbers are about 25 per cent larger and hog numbers some 15 per cent larger than at the outbreak of World War II. There should be a considerable increase in the tonnage of the better grades of beef and of pork reaching the market beginning in the last quarter of 1950.

Thanks to a 30 per cent increase in soybean acreage, stimulated by the sharp price rise this spring, and another prospective increase in lard production, a near-record supply of domestic fats and oils is indicated for the year ahead. With normal yields, soybean oil production will be boosted enough to offset a decline in cottonseed and peanut oil output from the government-curtailed acreage.

Surpluses Under Price Support

Pastures are furnishing ample feed and with abundant hay supplies in prospect milk production is running close to record high levels. The Government is taking huge quantities of butter,

cheese and dried milk off the market in an effort to hold up milk prices. The 10c a pound reduction in colored margarine beginning July 1, when the government tax came off, is providing price-fixed butter with stiff competition and the C.C.C., in order to avoid spoilage of upwards of 165 million pounds already owned, has been discussing with the trade the possibility of selling its hoard at prices more competitive with margarine.

Not only is the problem still one of surplus in dairy products, but it is also in eggs, flaxseed and potatoes. Although the potato crop this year was planted on the smallest acreage since 1876, the crop is indicated to be at least 60 million bushels in excess of requirements, involving the C.C.C. in another costly price support operation this year. Egg production is running even above wartime peak levels, and egg prices have dipped sharply below government price support levels despite a sharp step-up in the dried egg purchase program, which has been taking as much as 25 per cent of the Midwest surplus production off the market.

A Plentiful Sugar Supply

The supply of sugar is far in excess of normal requirements. Indeed, before the Korean crisis, steps were being taken to revive the International Sugar Agreement to bring world supplies down into line with demand. Both Cuba and Puerto Rico had been contemplating grinding restrictions on the next crop. Over and above normal world demands, Cuba, Puerto Rico and Hawaii together produced a surplus this year of some 1,250,000 tons in excess of what they had expected to sell. This is enough to add a two months' supply to industrial and household inventories in this country.

In response to the spurt in consumer demand, import quotas into the United States market already have been increased 350,000 tons to 7,850,000 tons and the United States Government has purchased the remaining surplus of 850,000 tons in Cuba, Puerto Rico, Hawaii, and the Virgin Islands to be made available over and above the present 7,850,000 ton quota when and as needed. Our own sugar beet acreage is 35 per cent larger than last year and is expected to produce a record crop. Actual consumption of sugar in this country probably never has exceeded 7,500,000 tons. Against this, we have an assured supply for 1950 of at least 8,700,000 tons.

Moreover, Cuba, the world's largest producer and our principal supply source, stepped up its new cane plantings sharply this past spring and with favorable weather could harvest a much larger crop next year.

The Half Year's Earnings

Reports for the second quarter and the half year issued during the past month by leading corporations reflect the marked recovery from the first half of 1949, when business activity and earnings generally were substantially lower than in the corresponding period of 1948. A tabulation of 500 statements issued to date, representative mostly of the larger manufacturing organizations but including also a number of companies in the mining, trade, and service industries, shows that for the first half year about two out of three had increases in earnings as compared with 1949, while for the second quarter about three out of four had increases.

Combined net income of the group for the first half year, after deducting federal income taxes computed at the 38 per cent prevailing rate, totaled approximately $2,568 million, an increase of 27 per cent over the total for the first half of 1949, and 20 per cent over the second half of 1949. If such taxes are computed at the 45 per cent rate, retroactive to January 1, as recommended by the President, however, the gains in net income over 1949 are cut to 13 and 6 per cent, respectively.

For the second quarter of 1950 alone, reported net income of the group totaled $1,450 million after taxes at existing rates, an increase over the corresponding 1949 quarter of 50 per cent. If taxes are raised as proposed, the increase is cut to 33 per cent. Following are the quarterly totals as reported:

1949	First quarter	$1,058,000,000
	Second "	964,000,000
	Third "	1,050,000,000
	Fourth "	1,097,000,000
1950	First "	1,117,000,000
	Second "	1,450,000,000

In the case of a great many of the reporting companies, the increases in earnings shown thus far this year, and particularly those registered in the second quarter, resulted not only from the high and rising rate of production, but also from the sustained heavy volume of sales and the stable or rising trend of commodity prices, in contrast with the first half of 1949 when in numerous lines both sales and prices slumped.

Sales figures for the first half year, now available for over two-thirds of the reporting manufacturing companies, show a combined gain of 8 per cent over the corresponding period of 1949. There were much sharper than average increases in a number of important lines, including textiles and apparel, automobiles and parts, electrical equipment and television, chemicals, cement, and paper. Sales of the steel group were up 3 per cent. Small decreases were shown in a

NET INCOME OF LEADING CORPORATIONS FOR THE SECOND QUARTER AND FIRST HALF YEAR

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income Second Quarter 1949	Reported Net Income Second Quarter 1950	Per Cent Change†	Reported Net Income Half Year 1949	Reported Net Income Half Year 1950	Per Cent Change†
28	Food products	$ 34,137	$ 36,043	+ 6	$ 69,877	$ 72,420	+ 4
12	Beverages	19,514	23,378	+ 20	39,467	38,569	— 2
11	Tobacco products	14,777	16,110	+ 9	28,310	29,541	+ 4
29	Textiles and apparel	10,812	32,177	+—	37,341	64,334	+ 72
21	Pulp and paper products	14,396	24,426	+ 70	33,664	46,519	+ 38
35	Chemicals, paints, etc.	93,022	163,002	+ 75	198,269	293,640	+ 48
9	Drugs, soap, cosmetics	8,481	12,455	+ 47	20,316	26,282	+ 29
20	Petroleum products	202,736	246,857	+ 22	438,682	452,367	+ 3
22	Cement, glass and stone	30,624	46,678	+ 52	56,930	80,853	+ 42
33	Iron and steel	134,087	215,020	+ 60	315,143	374,648	+ 19
17	Building, heating, plumbing equipment	7,697	14,543	+ 89	16,117	25,921	+ 61
21	Electrical equipment, radio and television	47,636	80,958	+ 70	99,403	156,725	+ 58
34	Machinery	20,758	30,299	+ 46	43,199	52,290	+ 21
10	Office equipment	16,766	17,068	+ 2	35,269	34,189	— 3
12	Automobiles and trucks	207,551	329,234	+ 59	371,608	547,573	+ 47
25	Automobile parts	18,963	34,776	+ 83	40,499	55,061	+ 36
10	Railway equipment	9,935	7,830	— 21	21,652	14,164	— 35
7	Aircraft and parts	4,018	8,663	+—	9,212	13,963	+ 52
48	Other metal products	14,245	37,294	+—	39,404	63,146	+ 60
25	Miscellaneous manufacturing	8,916	16,335	+ 83	20,568	28,142	+ 37
429	Total manufacturing	919,071	1,393,146	+ 52	1,934,930	2,470,347	+ 28
35	Mining and quarrying*	28,823	37,992	+ 32	54,100	61,860	+ 14
20	Trade (retail and wholesale)	7,053	9,554	+ 35	11,807	14,754	+ 25
16	Service industries	9,470	9,481	+ .1	20,699	20,620	— .4
500	Total	$964,417	$1,450,173	+ 50	$2,021,536	$2,567,581	+ 27

*Before depletion charges in some cases. †Increases or decreases of over 100% not computed.

few lines, including food products, beverages, office equipment, and railway equipment.

An additional factor, in many instances, in the earnings increase this year was the benefit of capacity operations of expanded and modernized plants and equipment. In such cases the rate of return upon the total of capital investment did not increase proportionately with the dollar earnings, and in the first quarter of this year the average rate of return was slightly lower than in 1949. A comparative summary of the earnings as reported is given in the accompanying table.

Public utility companies, not included in our summary, showed in most cases a further moderate growth this year in gross operating revenues. Despite higher tax payments, computed at existing rates, and rising fuel and labor costs, the net income for the gas, electric light and power, and telephone industries generally showed an improvement. With many individual utility systems, however, the expansion of facilities has been so great that their current rate of return on capital investment is now running considerably below that of recent years.

Railroad traffic and net income, which were curtailed by the coal strike in the first quarter, recovered in the second quarter, and figures for the first six months compare favorably with those of a year ago. The financial results this year have been helped by a tapering off in the heavy outlays for maintenance deferred during World War II, better control over expenses, and economies realized from the widened use of diesel motive power. Large orders for additional rolling stock have been placed recently, and the postwar programs for the improvement of physical properties has placed the railroads in a good position for meeting the demands of the war emergency.

Dividends and Working Capital

There has been some increase in dividend payments this year, but of much smaller proportions that the increase in corporate net income. According to the Department of Commerce compilation of all publicly reported dividends, the total payments in all lines of business during the first five months of 1950 increased 6 per cent over the corresponding period of 1949. Largest gains were in such manufacturing industries as oil refining, electrical machinery, chemicals, and automobiles, but decreases occurred in the textile, paper, and nonferrous metals groups. Among other branches of business, there were increased payments in the gas and electric utility groups, as well as in trade and finance, but decreases in mining and transporation.

Whereas in the first five months of 1949 the number of reduced and omitted dividends was larger than in 1948, and the number of increased or resumed dividends was smaller, these unfavorable trends were reversed in the comparison of the same periods of 1949-50.

The recovery in corporate earnings this year, together with the continued policy of paying out only a limited portion in dividends to shareholders, has added to the financial strength and

liquidity of American business for meeting the demands that are already developing from the Korean war. In a study released last month, the Securities & Exchange Commission estimated the net working capital of all U. S. corporations, excluding banks and insurance companies, at $69.0 billion as of March 31, 1950. This compares with $67.7 billion at the end of 1949, $51.6 billion at the end of 1945, and is almost three times the figure of $24.5 billion at the end of 1939. The percentage of current assets to current liabilities had risen by March 1950 to 224, compared with 213 at the end of the war, and only 182 in 1939.

Working Capital of All U. S. Corporations, Excluding Banks and Insurance Companies

(In Billions of Dollars)

	Dec. 31, 1939	Dec. 31, 1945	Dec. 31, 1949	Mch. 31, 1950
Current Assets				
Cash	$ 10.8	$ 21.7	$ 24.9	$ 23.7
U. S. Govt. securities	2.2	21.1	15.7	16.7
Receivables, net	22.1	25.9	38.8	38.7
Inventories	18.0	26.8	43.8	44.2
Other current assets	1.4	2.4	1.4	1.5
Total current assets	54.5	97.4	124.1	124.8
Current Liabilities				
Notes & accounts payable	21.9	25.7	33.7	32.8
Federal income taxes	1.2	10.4	9.7	9.7
Other current liabilities	6.9	9.7	13.0	13.2
Total current liabilities	30.0	45.8	56.4	55.8
Net Working Capital	24.5	51.6	67.7	69.0
Ratios:				
Current assets to current liabilities—%	182	213	220	224
Cash & govt. securities to current liabilities—%	48	93	72	72

Sources: Treasury Department annual "Statistics of Income" for 1939-45; Securities & Exchange Commission estimates for 1949-50.

With this strong working capital position, and with greatly expanded and modernized plant and equipment financed largely from retained earnings, the industries have the capacity to turn out both military and civilian goods in far greater quantity than at the outbreak of World War II. This enlarged capacity in so many of the basic industries should tend to be a restraining influence on shortages and the resulting inflation of prices.

Mortgage Credit and the Housing Boom

Sustained periods of prosperity in the American economy have usually been accompanied by high levels of construction activity, active real estate trading, and rising real estate prices. The postwar years have been no exception. The present housing boom, as is widely recognized, has been one of the principal supports of the current prosperity; at the same time prosperity incomes have provided a basis for increasing housing demand.

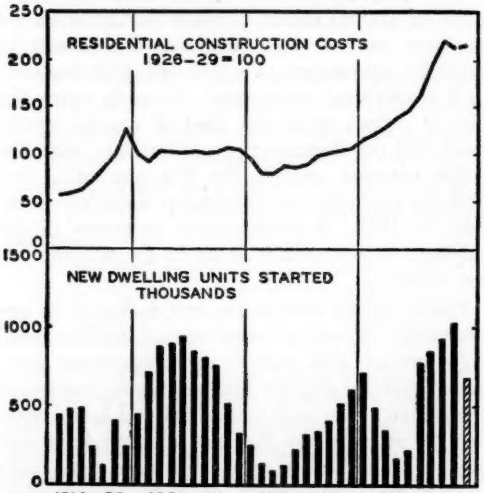
Factors of great strength have been responsible for this housing boom. Prominent among these have been a large pent-up demand for housing; increases in population growth and family formation; extensive regional shifts in population; high individual incomes and accumulations of liquid assets; and, finally, the availability of mortgage credit on increasingly liberal terms.

The rise in home mortgage indebtedness, an inevitable accompaniment of a housing boom, has been viewed with increasing concern by many observers who recall the mortgage debacle of the '30s. They wonder whether we are not heading sooner or later for a similar period of mortgage grief.

More recently, the whole question of mortgage credit and the level of mortgage debt has been made more urgent by the prospects of renewed inflationary effects of expanding expenditures for national defense, and by the need to conserve materials for defense requirements.

Magnitude of Home Building Boom

In the accompanying diagram we give a comparison of present home building activity with that of the housing boom in the '20s.



RESIDENTIAL CONSTRUCTION ACTIVITY AND COSTS
Number of new non-farm dwelling units started, annual totals (1950, first six months only), source: U. S. Bureau of Labor Statistics. Residential construction costs, 20 cities, annual averages (1950, average of first four months only), source: E. H. Boeckh and Associates, Inc.

It will be seen that, on an annual basis, the current building boom is exceeding that of the '20s. Whereas in 1925 – the peak year of the earlier boom – 937,000 non-farm dwelling units were started, in 1949 starts totaled 1,026,000 units. In the first six months of 1950 new housing starts totaled 687,000 units, a rate which if continued would carry the year's aggregate far in excess of any previous record.

On the other hand, whereas the 1920 boom continued at a high rate for seven years, 1922-28, the present boom has been in progress only four and a half years.

As may be seen from the diagram, there was relatively little building during most of the '30s and in the war years 1942-45. In this way a real "gap" in the housing supply had come into existence by the end of the war.

Inflation of Values

As the diagram also shows, building costs have risen almost continuously since prewar, with the steepest rise occurring since 1945. While costs eased some in 1949, the trend in 1950 has been again upward. Present costs are about double those at the beginning of World War II, and some 50 per cent higher than at the end of the war.

In contrast, changes in building costs during World War I culminated in a high in 1920, before the boom of the twenties gained headway. Then costs, after settling back to a considerably lower level, increased but moderately while the boom was actually in progress. In other words, the present housing and mortgage boom has been carried forward under conditions of rapidly rising costs; that of the '20s was accomplished with only moderate cost increases.

High building costs affect the quality of mortgage debt through their effect on real estate values, making it necessary to borrow more money in order to buy a home.

Indexes of home prices are not easily constructed, but one based on advertised asking prices in Washington, D. C., is presented in a forthcoming publication of the National Bureau of Economic Research — "Urban Real Estate Markets and Their Financing Needs", by Ernest M. Fisher, Professor of Urban Land Economics, Columbia University. The index, as the author points out, is subject to qualification; but it is at least suggestive of real estate price changes in other areas. It shows that the median advertised asking prices of homes rose from about $6,500 in 1939 to approximately $12,000 in 1947 (latest figures). The level of prices is probably now only moderately below that of 1947. In short, real estate values in that area have about doubled since 1939, an increase roughly proportionate to the increase in building costs.

In contrast, Washington, D. C. home prices rose by 60 per cent from 1918 to their peak in 1925, and during the actual housing boom of the '20s, rose by only 15 per cent, an increase about proportionate to the building cost increase of that period.

In other words, while in its physical aspects the current boom in home building has not — save in the last year and a half — reached a level comparable with that of the '20s, in its financial aspects it has exceeded that of the '20s. This is of paramount importance in appraising the present mortgage debt situation.

Influence of Federal Mortgage Policies

Home mortgage debt has risen from about $18 billion in 1939 to about $38 billion in early 1950. Data prior to 1925 are not available, but home mortgage debt then stood at $13 billion and by 1930 had risen to $20 billion. In other words, we have added about as much to the mortgage debt since 1939 as the total outstanding at the end of the '20s.

It is not difficult to explain why the two booms show such varying rates of increase in mortgage debt. First, the proportion of owner-occupied houses bought on a mortgage basis is tending to increase, and more so in recent years owing to the Federal Government's liberal credit policies.

Second, comparable homes are now selling at prices considerably higher than in the '20s, making larger loans necessary. Here too the governmental policy of continuous liberalization of mortgage lending terms would appear to be a principal factor. Easier credit has a price-raising effect in a seller's market. Certainly, with full employment conditions in construction, easier credit cannot be expected significantly to increase the supply of homes.

Third, and finally, it has been government policy to encourage smaller down payments, which results in increased debt.

These fundamentally inflationary public policies have at times conflicted with public policy in other credit areas where, as in consumer credit and business financing, federal authorities have endeavored to exert a restraining influence. The Government's inflationary mortgage financing policy took another long step forward in the Housing Act of 1950, adopted in April, which raised maximum loan limits, maturities, and loan-to-value ratios, and in the lowering at the same time of interest rates on Federal Housing Administration insured loans from 4½ to 4¼ per cent. The recently announced tightening of home mortgage credit terms has changed this situation but slightly.

On balance, one may doubt whether easier mortgage terms have benefited borrowers. In the National Bureau study referred to above, Professor Fisher concludes that the principal effects of the liberalization of credit terms after 1938 were to enable individual mortgagors to borrow

larger amounts and to pay higher prices for homes, without appreciably improving the quality of the housing they acquired.

Expansion Shared by All Lending Agencies

That each of the principal institutional groups lending on mortgages has participated heavily in this credit expansion is brought out in the accompanying table.

Home Mortgages Held by Principal Institutional Lenders*

(Dollar Figures in Billions; End of Year)

	Amt. Held	Percent Increase	% of All Home Mtg. Debt Held		% of All Loans and Investments in Home Mtgs.	
	1949	1939-49	1939	1949	1926	1949†
Commercial banks	$6.1	248%	10.0%	16.4%	2.2%	3.9%
Insur. companies	5.9	296	8.5	15.9	8.2	10.0
Savings and loan associations	11.6	209	21.8	31.2	90.7	79.7
Mutual sav. banks.	3.2	50	12.1	8.6	31.5	14.8

*Data from reports of the Federal Savings and Loan Insurance Corporation and the Housing and Home Finance Agency. All 1949 figures are preliminary.

†Estimated.

As against an overall increase in home mortgage debt of about 110 per cent from 1939 to 1949, holdings of life insurance companies, commercial banks, and savings and loan associations increased by 296, 248, and 209 per cent, respectively; holdings of mutual savings banks, on the other hand, grew by only 50 per cent.

As a result of these differentials the relative importance of the main lenders has changed. As will be seen in the table above, the share of home mortgage debt held by mutual savings banks has fallen since 1939 while the shares held by other institutional lenders have risen.

Of the total of all home mortgage debt, these institutional lenders at the end of 1949 held 72 per cent as against 52 per cent in 1939. Owing, however, to the larger increase in their available funds, these institutions in most cases have been able to absorb a larger volume of mortgages with little or no increase in their relative commitment in this type of investment. As the table shows, the percentages of mortgage holdings to total assets of insurance companies and savings and loan associations are not far different than in the '20s, while that for mutual savings banks is actually very much less. Savings and loan associations are the most heavily committed, with about 80 per cent of their assets in this type of investment; insurance companies and commercial banks have only 10 per cent and 3.9 per cent, respectively.

Lessons of the '30s

As concern grows over the expansion of mortgage debt and what it may lead to, the question naturally arises as to what lessons can be learned from the aftermath of the mortgage boom of the '20s.

The mortgage debacle of the '30s is dramatically illustrated in the shrinkage, mainly through defaults and foreclosures, in total home mortgage debt by some $3 billion from its peak of $20 billion in 1930, to mid-1933 when the Home Owners Loan Corporation was established by Congress to refinance distressed home loans. (By that time 33 states had passed special laws to relieve stricken mortgagors.) When the HOLC was opened for business in 1933 it was flooded with applications: by the time operations were suspended in 1936 more than a million loans totaling over $3 billion had been granted.

The collapse in values of course hit mortgage lenders who survived, as well as those who failed. Some indication of the experience of surviving lenders – naturally better than that of all lenders – appears in a forthcoming report on the mortgage experience of commercial banks made cooperatively by the National Bureau of Economic Research and the Federal Deposit Insurance Corporation, and in a companion report on the experience of leading life insurance companies recently published by the Bureau. In the case of the commercial banks, a sample of home mortgage loans made by 116 banks which rode through the depression shows that about 8 per cent of those made in 1920-29 were ultimately foreclosed. Losses on operation and sale of the properties taken over averaged 23 per cent of the original amount loaned. The sample from the insurance companies shows that 16 per cent of their home mortgage loans made in 1920-29 were eventually foreclosed, and that the final loss was about 9 per cent of the original amount loaned.

Further analysis of these experiences reveals that the dominant factor in the quality of mortgage loans is the character of the economic conditions prevailing at, and immediately following, the time they are made. Mortgage loans made in periods of low real estate activity and prices have fared best; conversely, loans made in real estate expansions have been least satisfactory. Thus, 11 per cent of the sample of urban home mortgage loans made by commercial banks in 1925-29 eventually went to foreclosure, as against 3 per cent of those made in 1920-24, and only 6 per cent of those made in 1930-34. The experience of the insurance companies was broadly similar: 21 per cent of the sample of the home loans made by them in 1925-29 eventually defaulted, and only 5 per cent of those made in 1920-24.

These facts suggest an important lesson, namely, that booms generate low quality mortgages — a warning that lenders might well take to heart at this time.

Elements of Strength and Weakness in Present Situation

In comparing mortgage conditions now and in the '20s, it is necessary, however, to recognize that elements of both strength and weakness presently exist.

On the favorable side, one factor is that, while the home mortgage debt has increased, so have disposable personal incomes. The ratio of debt to disposable incomes in 1949 — 20 per cent — was actually lower than in 1939 and about the same as in the middle '20s. While the ratio has been rising rapidly it is still below the levels of the late '20s.

Secondly, a tripling of the liquid assets of individuals means that many families have resources to draw upon in the event of a decline or loss of income due to adverse economic conditions.

Thirdly, it is likely that nearly 50 per cent of the mortgages now being acquired by financial institutions are either insured by the FHA or guaranteed by the Veterans Administration. All of these insured loans, and many of the noninsured loans now made by institutional lenders, are of the fully amortized type. The proportion of mortgages granted in the '20s on this basis was negligible.

This widespread practice of full amortization by maturity is, of course, an improvement in our mortgage debt structure. For one thing, it reduces the amount of second (and even third) mortgages, at very high interest rates, which were a source of so much difficulty in the '20s. Now, by permitting higher borrowing ratios — in some cases as high as 95 per cent — loan insurance has in effect written junior debt into the first mortgage. However, the total debt is more clearly visible in this form. Also, it is now commonplace to require that taxes and insurance be paid along with interest and principal, which further improves the quality of the credits.

The main weakness, undoubtedly, in the present mortgage situation lies in inflated real estate prices and the lengths to which government policy of encouraging longer-term loans and higher borrowing ratios has been carried. Under the Government's liberalized credit policies, FHA has until recently insured mortgages written for 30-year periods and with loan-to-value ratios up to 95 per cent. In the case of ex-service men, the Veterans Administration has enabled veterans to buy homes without paying any money down, and even under the tighter terms recently announced only a 5 per cent down payment is required. Consequently, it now takes longer for the home owner to build up any appreciable equity. The loan "seasons" more slowly.

Such conditions have the effect of offsetting the strengthening influence of the regular reduction of principal through scheduled amortization payments.

With mortgage loans being written with such low equities and long repayment terms, the prevention of wholesale defaults would seem, when all is said and done, possibly more dependent than ever upon the avoidance of any sharp decline in real estate values or contraction of the national income. The longer the building and mortgage boom is prolonged by excessively easy credit terms, the more likely of realization becomes the warning of the editor of the New York Journal of Commerce that —

> this is building up to a big headache for all concerned. The Government some day is going to be asked to make good on large amounts of insurance and guaranteed mortgages. Financial institutions will face serious red tape and public relations problems, should foreclosures of these mortgages ever reach large proportions. Veterans and others now assuming heavy mortgage obligations will clamor for relief. And the economy as a whole will be hurt from too much building at one time that leads to subsequent curtailment of home construction.

The prospect that the country now faces intensified inflationary pressures as a result of increased military spending postpones but does not eliminate these dangers. The tightening of mortgage lending terms recently called for by the President, while intended as a move to conserve materials needed for national defense, is also a much needed step in the direction of putting the mortgage lending program on a sounder basis.

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